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JULY 1988 MONTHLY SURVEY

Surveys of Consumers

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Cautious Optimism

Index slips

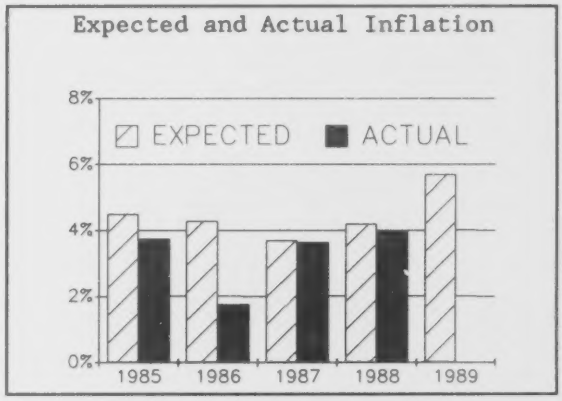
The Index of Consumer Sentiment was 93.0 in the July 1988 survey, down from 94.7 one month earlier, and 93.7 one year earlier. This small decline was due to less favorable assessments of prospects for the economy during the upcoming year. Rising inflation and interest rates continue to be of great concern to consumers.

Among families with incomes of $30,000 or more, the Index fell to 100.4 in the July 1988 survey, down two Index-points from the month and year earlier readings.

Higher Inflation Rate Expected

In the July 1988 survey, consumers expected the rate of inflation to average 5.7% during the year ahead, confirming the sharp rise to 5.6% recorded in June. This inflation outlook is substantially higher than the 4.2% recorded one year earlier, or the 3.7% recorded two years earlier. The extensive media coverage given to the drought has heightened fears of potential increases in food prices.

The accompanying chart compares the expected and actual inflation rates. Using the July surveys, consumer expectation for the year ahead inflation rate are compared with the actual percentage change in the CPI-U during that subsequent year. The survey data are led one year--thus, the July 1988 survey is shown as the expected 1989 inflation rate. The data indicate a rather close correspondence between prior expectations and the subsequent increases



in prices during the past two years, while consumer expectations in 1985 were considerably higher than the actual, and very small, increase recorded in 1986. Although consumer price expectations are now at a five year high, they are still less that half the double digit levels recorded at the start of this decade.

Interest Rate Increases Expected

Interest rates were expected to increase by 64 percent of all families in the July 1988 survey, a reading that has remained largely unchanged during the past two months. This represents a substantial increase from the post crash low of 44 percent recorded in February 1988, and returns interest rate expectations to the very unfavorable levels recorded from May through October of last year.

Personal Finances Remain Strong

Despite the heightened awareness of potential increases in inflation during the year ahead, at present American families continue to view their own personal financial situation in favorable terms. Few families registered complaints about current prices, and more families reported recent income gains.

Among all families in the July 1988 survey, 45 percent reported that they were financially better off than a year earlier, up from 43 percent one month earlier, and equal to the year earlier reading. Income increases were reported by 39 percent of all families in the July survey, up from 32 percent one month earlier and 36 percent one year earlier. Just 11 percent singled out recent price increases as the cause of a worsened financial situation, largely unchanged from one and two years earlier.

Consumers continued to hold favorable prospects for their own financial situation during the year ahead. In the July 1988 survey, 36 percent of all families expected their financial situation to improve, between the 39 percent recorded one month earlier and the 34 percent recorded one year earlier. Just 10 percent of all families expected their financial situation to worsen during the year ahead.

Outlook for Economy Weakens

Consumers' evaluations of prospects for the national economy weakened in the July 1988 survey, following their strong recovery from the post crash lows. Importantly, these views still remain generally favorable, although they have weakened during the past year.

Fewer consumers thought that the economy had improved in the July 1988 survey--44 percent, down from 47 percent one month earlier and 50 percent one year earlier.

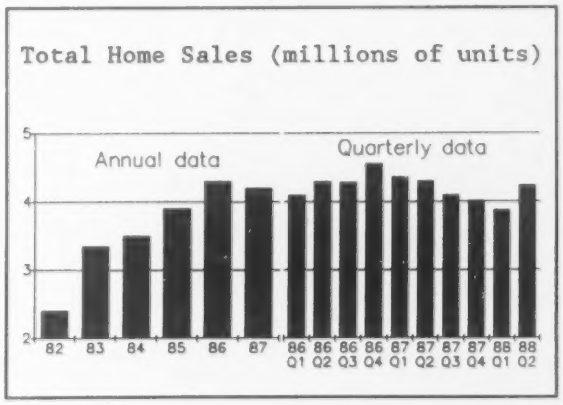
And fewer consumers expected the economy to improve during the year ahead. Good times financially in the country as a whole were expected by 44 percent of all families in the July 1988 survey, down from 54 percent in June, and 51 percent in July 1987. Bad times financially were expected by 40 percent in July 1988, up from 33 percent both one month and one year earlier.

Buying Attitudes Remain Favorable

Attitudes toward buying conditions for homes, vehicles, appliances, furniture, and home electronics have remained at favorable levels in the recent survey.

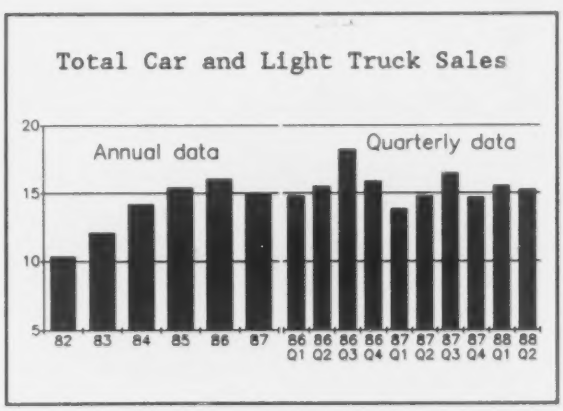
Favorable attitudes toward buying conditions for homes were held by 72 percent of all families in the July 1988 survey, a level that has remained largely unchanged during the past four months. This represents a sharp improvement over the low of 58 percent recorded last November, regaining all the ground lost during the past year.

As shown in the chart below, sales of new and existing single family homes in the second quarter of 1988 posted the first quarterly increase since the end of 1986 (favorable home buying attitudes reached their cyclical peak early in 1986).



Favorable attitudes toward buying conditions for appliances, furniture, and home electronics were held by 79 percent of all families in the July 1988 survey, although only slightly above the 76 percent recorded last July, it is the highest proportion recorded since mid 1986.

Favorable vehicle buying attitudes were held by 62 percent of all families in July 1988, unchanged from one month earlier, somewhat lower than the year earlier reading of 67 percent. Total unit sales of cars and light trucks remained at very favorable levels during the first half of 1988, showing only a very small decline in the second quarter. The pattern of quarterly sales rates are dominated by the third quarter peaks, corresponding to the periods of deep discounting by vehicle manufactures. A pattern that consumers have now come to expect.



Changing Purchase Rationales

Although the overall incidence of favorable buying attitudes has not changed, the reasons given by consumers for the favorable attitudes have changed. Compared with a year earlier, consumers much less frequently cited the availability of low interest rates on credit purchases in the July 1988 survey. When asked about home buying conditions, the proportion of families that cited low mortgage rates fell to 31 from 46 percent during the past year, and for vehicle purchases, favorable mentions of low interest rates fell to 15 from 28 percent.

But the opposite was not true: complaints about high interest rates have not increased in frequency. Thus, increases in interest rates have meant that current rates are no longer viewed as a positive attraction, but thus far the extent of those increases have not been viewed as a cause for postponement of purchases.

Indeed, rather than postponement, consumers are now as likely apt to cite the appeal of borrow-in-advance of rising interest rates. In the July 1988 survey, as many families mentioned the appeal of borrowing-in-advance of rising mortgage rates as thought that current mortgage rates were already too high and cause for postponement (12 versus 11 percent).

In contrast to their reaction to impending interest rate increases, consumers are not likely to react to escalating prices with advance buying. The inflation fears are focused on food prices, not on the prices of homes, vehicles, appliances, furniture, or home electronics. Quite the contrary: consumers still expect, and are willing to wait for, price discounts.

This continued reliance on discounts is nowhere more evident than in the vehicle market. Unlike home buying attitudes, references to borrowing-in-advance of rising interest rates on vehicle loans have not increase in frequency. This reflects the now more common reaction of consumers to wait for renewed discounting by vehicle manufacturers rather than speed up their purchases. In it place, the strength in vehicle buying attitudes has been maintained by the continued availability of price discounts.